

May 22, 2002

The Honorable Harvey L. Pitt  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Dear Chairman Pitt:

We are writing to request clarification of the Commission's views on the continuation of exemptions from various provisions of the federal securities laws provided by the federal charters of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). As you are aware, the charters of these entities provide that securities issued or guaranteed by them (other than guaranteed securities backed by mortgages not purchased by them) shall, to the same extent as obligations issued or guaranteed by the United States, be deemed to be exempt securities within the meaning of the laws administered by the Commission.

We have introduced H.R. 4071, a bill that would eliminate these exemptions. As you know, our bill is consistent with the recommendations made in 1992 by the Board of Governors of the Federal Reserve System, the Department of the Treasury and the Securities and Exchange Commission and is attracting an increasing number of cosponsors in the House.

The principal effect of the current exemptions is to relieve Fannie Mae and Freddie Mac, as well as their insiders, of the obligation to comply with various requirements of the federal securities laws to which other public companies (including direct competitors) and their insiders are subject. Among other things, Fannie Mae and Freddie Mac are not required to:

- Register under the Securities Act of 1933 securities issued or guaranteed by them, or pay related filing fees;
- Register under the Securities Exchange Act of 1934 securities issued or guaranteed by them that are listed on a national stock exchange;
- File annual, quarterly and other periodic reports required by Sections 13 and 15(d) of the 1934 Act;

- Comply with the requirements for tender offers set forth in Section 13 of the 1934 Act;
- Provide the voting, executive compensation and other disclosures required by Section 14 of the 1934 Act for proxy and information statements issued by them;
- Comply with the independent trustee and other requirements of the Trust Indenture Act of 1939.

In addition, insiders of Fannie Mae and Freddie Mac are not required to:

- File reports under Section 13(d) or (g) of the 1934 Act when their holdings of a class of their company's listed securities exceed 5 percent;
- File reports under Section 16(a) of the 1934 Act of their ownership of, and transactions in, equity securities of their company;
- Disgorge to the company under Section 16(b) of the 1934 Act profits realized by them on short-swing transactions involving their company's equity securities;
- Adhere to the prohibition on short sales of their company's equity securities prescribed by Section 16(c) of the 1934 Act.

The blanket exemption from the above requirements was first provided at a time when the securities issued by Fannie Mae were backed by the full faith and credit of the U.S. government. As a result, investors were not at risk with respect to such securities, and many of the protections afforded by the above provisions were unnecessary. Moreover, the prevailing view was that the mission of Fannie Mae (and later Freddie Mac) to create a broad and liquid secondary mortgage market would be better served if these entities were not subjected to the burdens of the above requirements.

In the decades that have passed since the exemptions for Fannie Mae and Freddie Mac were established, the two entities and the markets in which they operate have changed dramatically. There is no government guarantee of their securities. Both entities now have a large number of equity holders, whereas formerly there were none. As a result, the many investors in their debt and equity securities are at complete risk, to the same degree as investors in securities of all other members of the Fortune 500 with publicly-traded securities, unlike the situation when the exemptions were established.

The secondary mortgage market which Fannie Mae and Freddie Mac were chartered to establish and promote also is vastly different from the periods when the exemptions for these entities were put in place. Whereas there was little or no secondary market for mortgages at the time these entities began their mission, there now is a thriving trillion-dollar market for mortgages that is extremely liquid. Both Fannie Mae and Freddie Mac have accomplished their primary objective of creating a secondary market that allows the prompt resale of mortgages by lenders on profitable terms and the immediate reinvestment of the proceeds by the lenders in new loans to homebuyers. As a result, there is no discernable need to continue the securities law exemptions, particularly in light of the massive amount of securities issued by them on an ongoing basis to public investors. The Commission, together with the Department of the Treasury and the Board of Governors of the Federal Reserve System, reached the same conclusion in a Joint Report issued in January 1992, and we are not aware of any events in the intervening decade that would warrant a different conclusion today.

Although Fannie Mae and Freddie Mac continue to be the most important players in the secondary mortgage market, the market is a fully functioning one that no longer depends solely on their presence to provide liquidity. Banks, insurance companies and others now compete with Fannie Mae and Freddie Mac in this market, and contribute greatly to its smooth operation, particularly in the jumbo mortgage market. Although these other entities do not have exemptions from the federal securities laws of the type provided to Fannie Mae and Freddie Mac, the burdens of complying with those laws have not prevented these entities from being competitive. This confirms that subjecting Fannie Mae and Freddie Mac to these requirements would neither impair unduly their ability to promote the market on a continuing basis, nor impact adversely the smooth functioning of the market.

The experience of the competitors of Fannie Mae and Freddie Mac in complying with the securities laws is instructive. The competitors have found that the registration fees payable under the 1933 Act are not a significant cost factor when conducting individual offerings of mortgage-backed or other securities, and that unanticipated delays in conducting offerings are uncommon, due to the existence of shelf registration, add-on registration, and other techniques for meeting market demand on a timely basis. Although Fannie Mae and Freddie Mac contend that the extremely high volume of mortgage-backed and other securities offerings issued or sponsored by them would result in delays in processing their filings, we know of no basis for this assertion. The shelf registration procedures available to registrants would assure that shelf takedowns, the most common form of large volume offering, would not be open to review by the Commission staff and therefore could occur without any delay. To the extent offerings other than shelf takedowns were involved, the selective review procedures employed by

the Commission staff for the past several decades would help assure that only truly unique offerings would be subjected to staff review and therefore be subject to potential delay. We do not believe any responsible person would contend that review by the SEC staff of such offerings would be inappropriate, or not be beneficial to investors.

Eliminating the exemptions that currently are available to Fannie Mae and Freddie Mac would merely require these entities to conform their disclosure documents, such as prospectuses for public offerings, periodic reports of company developments, and proxy statements relating to meetings of security holders, to SEC requirements. Currently, there are no affirmative disclosure requirements that apply to Fannie Mae and Freddie Mac, with the result that they have complete discretion to include or exclude information from such documents, regardless of the perceived importance of the information to investors. Accordingly, Fannie Mae and Freddie Mac are free to depart from their stated disclosure policy at any time without fear of adverse consequences. If such a departure were to occur, investors would be left with no recourse, since no statutory requirement would have been violated by a failure to include information not affirmatively required by law. Moreover, the disclosure documents issued by Fannie Mae and Freddie Mac are not available to the public in the readily accessible form provided by the Commission's EDGAR electronic disclosure system, making comparisons of their disclosures to other public company participants in the secondary mortgage market difficult.

Fannie Mae and Freddie Mac argue that they voluntarily disclose more information than would be required if they were to register with the SEC, so there is no need to subject them formally to SEC requirements. But even if this is true (and we are not sure it is), there is no regulatory presence to assure that they abide by their stated policy. Their current regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO"), is principally concerned with the safety and soundness of Fannie Mae and Freddie Mac and has no experience in administering the complex disclosure and other requirements of the securities laws. If OFHEO, either by its own authority or through a statutory directive enacted in the future, were to attempt to impose SEC-type disclosure requirements on Fannie Mae or Freddie Mac, it clearly would lack sufficient staff to deal with the large volume of securities offerings that Fannie Mae and Freddie Mac contend would overwhelm the vastly superior resources of the SEC.

It also is important to note that the restraints on trading imposed by Sections 13(d) and 16 of the 1934 Act that normally apply to public company insiders do not apply to insiders of Fannie Mae and Freddie Mac. Fannie Mae recently announced that it would post on its Web site information about transactions and holdings by its insiders, and Freddie Mac agreed to follow suit. To date the only information published has been limited to the current holdings of such persons. But even if these entities were to publish

information about the securities activities of their insiders on the basis announced by Fannie Mae (*i.e.*, “within several days of the acquisition or disposition of equity securities”), the information would not be published as rapidly as required by the applicable provisions or pending Commission proposals. Nor would the information achieve the widespread dissemination that reports filed by public company insiders with the Commission receive. Moreover, the insiders of these companies would continue, in stark contrast to other public company insiders, to be able without any legal limitation to engage in in-and-out trading of the type discouraged by Section 16(b) and in short sales of the type prohibited by Section 16(c). This type of trading activity was found to have contributed greatly to the onset of the Great Depression, but no legal recourse is now available to the company or its investors if its insiders were to engage in such activity.

In examining the question whether the exemptions provided to Fannie Mae and Freddie Mac should be continued, we think the experience of the only other publicly-traded government-sponsored enterprise, the Federal Agricultural Mortgage Corporation (“Farmer Mac”), is relevant. Farmer Mac was formed more than 14 years ago to develop and promote a liquid secondary market for agricultural loans. No exemption from the federal securities laws has ever been provided to Farmer Mac, yet it has not found the absence of such an exemption to be a significant hindrance to furthering its mission or to conducting its daily operations. Farmer Mac makes filings with the SEC in the same manner as other public company registrants, and has experienced substantial growth in a relatively short period of time. More importantly, the market for agricultural loans continues to expand and the liquidity of that market continues to improve. Accordingly, the experience of Farmer Mac would appear to belie the contention by Fannie Mae and Freddie Mac that eliminating their exemptions would prevent them from furthering their mission.

In light of the foregoing, we ask the Commission to advise us whether it supports our position that the exemptions for Fannie Mae and Freddie Mac should be eliminated, thereby vesting the Commission with the authority to apply the securities laws fully to these entities and their insiders. If the Commission does not support our position, we request an explanation of the reasons why it believes the exemptions provided to Fannie Mae and Freddie Mac continue to be necessary or appropriate, and to indicate why its position has changed from the 1992 Joint Report referred to earlier. In considering this matter, we believe it would be appropriate for the Commission to pay particular attention to the following:

- The substantial amount of public investor funds (over \$3 trillion) at risk and the exposure of public investors that presently results from a less-than-full application of the federal securities laws to Fannie Mae and Freddie Mac;

- The freedom of Fannie Mae and Freddie Mac to establish their own disclosure requirements, rather than conform to requirements established and administered by the Commission, with the result that, as of any point in time, the levels of disclosure may well depend on the identities and predispositions of their incumbent managers;
- The needs of existing and potential equity investors in these entities for regularized, systematic and uniform disclosures to enable them to compare investments in these entities with potential investments in the equity securities of other issuers;
- The absence of oversight of the securities activities of Fannie Mae and Freddie Mac by a regulator experienced in securities law disclosures;
- The absence of the protections against overreaching by insiders of Fannie Mae and Freddie Mac provided by Sections 13 and 16 of the 1934 Act;
- The absence of ready access by the public to disclosure documents issued by Fannie Mae and Freddie Mac of the type available on EDGAR for all other public companies;
- The competitive advantage afforded to Fannie Mae and Freddie Mac by not having to comply with the disclosure, fee and other requirements of the securities laws applicable to their competitors.

Finally, both of us are concerned by statements you made on March 20, 2002, which put the Commission's position on Fannie Mae and Freddie Mac's exemptions from federal securities laws in question. In response to a question posed to you before the House Financial Services Committee regarding the SEC's position on the 1992 Joint Report on the Government Securities Market, in which the Commission, the Treasury and the Federal Reserve recommended repealing the GSEs' exemptions from the federal securities law, you responded:

We have not changed our general position, but we have not refocused on it. I will say in this day and age, I believe transparency has to be the order of the day. To the extent that the exemptions permit anything less than transparency, which I believe is the case, I believe at least that portion has to be removed. Frankly, I could care less whether the GSEs pay registration fees or things of that nature, but I do believe that disclosure is critical for the GSEs as well as for other public companies.

Later that day, the Commission prepared a comment for the media, which stated:

In response to a question regarding the obligations of GSEs, Chairman Pitt told the House Financial Services Committee today that, as a matter of principle, all publicly traded companies, including GSEs, should meet the highest standards of disclosure and transparency. Neither Chairman Pitt nor the Commission are advocating any change in the legal status of GSEs.

Because the 1992 recommendations were the product of formal action by the Commission, we would be interested in learning whether the Commission had met to reconsider its 1992 position prior to March 20 and whether it has done so since that date.

We look forward to a prompt response to our inquiry and request that a response be provided within 15 business days. Should you have any questions about this request, please have your staff contact Mr. Len Wolfson (Rep. Shays) at 225-5541 or Mr. Jeffrey S. Duncan (Rep. Markey) at 225-2836.

Sincerely,

Christopher Shays  
Member of Congress

Edward J. Markey  
Member of Congress